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In the Matter of Policy and Rules Concerning Rates for  
Dominant Carriers, Part 1 of 3

CC Docket No. 87-313

FEDERAL COMMUNICATIONS COMMISSION

4 FCC Rcd 2873; 1989 FCC LEXIS 860; 66 Rad. Reg. 2d (P & F)  
372

RELEASE-NUMBER: FCC 89-91 37691

April 17, 1989 Released; Adopted March 16, 1989

ACTION:    [\*\*1]   REPORT and ORDER and SECOND FURTHER NOTICE  
                  of PROPOSED RULEMAKING

OPINION:

[\*2876]   By the Commission: Commissioners Patrick, Chairman; and Quello  
          ssuing separate statements; Commissioner Dennis concurring and issuing a  
          tatement at a later date.

for the propositions that a monopolist with economies of scale may be able to discourage competition without pricing below average variable cost, and that a monopolist with excess capacity may be able to implement such a strategy without pricing below average total cost. n1039 NTN then argues that, since AT&T enjoys both economies of scale and excess capacity, use of the average variable cost standard will not only not prevent AT&T from predating, but will amount to practical deregulation of AT&T's prices. n1040 NTN also contends that average variable cost, to the extent it has been adopted by courts, has been used only as a threshold below which prices could be presumed predatory, and that this is not the same as adopting average variable cost as a criterion for deciding whether a firm has engaged in predation. n1041

n1038 NTN Comments at 16-20.

n1039 NTN Comments at 16-17, quoting Scherer, *Predatory Pricing and the Sherman Act: A Comment*, 89 Harv. L. Rev. 869, 871 (1976).

n1040 NTN Comments at 17, 19; accord Cable & Wireless Comments at 31.

n1041 NTN Comments at 18. NTN also cites a string of cases which, it claims, demonstrates that courts do not fully accept average variable cost as a test for predation. Id. at n.27.

497. In reply, AT&T asserts that the analysis upon which NTN relies was intended to address a situation in which a monopolist could acquire excess capacity for the sole purpose of discouraging competitive entry. AT&T states that this analysis is irrelevant to the interexchange industry, because numerous competitors already have sunk excess capacity that cannot be driven

[\*3114] out of the market by AT&T's lowering its prices. n1042 AT&T cites its own academic authority to the effect that, in order to avoid chilling competitive price reductions, this Commission should require a strong showing to rebut that presumption, and should entertain such challenges only after the price increase has taken effect and actual market evidence is available. n1043

n1042 AT&T Reply at 44-45.

n1043 AT&T Reply at 45-46, citing statement of P. Areeda, AT&T Comments, Appendix A at 12-13, and P. Areeda & D. F. Turner, *Scherer on Predatory Pricing: A Reply*, 89 Harv. L. Rev. 891, 897 (1976). AT&T also cites numerous court cases in support of the position that average variable cost is a rational test that permits genuine price competition while protecting against predation. AT&T Reply at 47 n.\*.

### iii. Discussion

498. We affirm our tentative conclusion that a tariff proposing below-band rates should be filed on 45 days' notice and accompanied by a showing that the rates cover the cost of service and are otherwise just, reasonable, and nondiscriminatory. For the purpose of initial review of such tariffs, we adopt the average variable cost standard as the standard for determining whether a proposed rate decrease must be suspended pending investigation.

499. Price reductions are ordinarily good for consumers, though not pleasing

to competitors. Predatory pricing, though often alleged, is generally uncommon, and proven cases are rare. n1044 We have, through the structure of AT&T's service baskets, n1045 created conditions under which predation should be as unlikely in the interexchange telecommunications market as it is in the economy generally. Although an abundance of caution has led us to deny streamlined treatment to below-band rate decreases, we are convinced that such below-band reductions as are possible within the limits of our price cap scheme are more likely to be competitive than predatory. Such reductions should, therefore, be reviewed against a standard which requires suspension only of those rates which are so low that they can be presumed to be anticompetitive. As AT&T's competitors point out, average variable cost is just such a standard.

n1044 See P. Areeda & D. Turner, *Antitrust Law* (1978) P711; R. Koller, *The Myth of Predatory Pricing: An Empirical Study*, 4 *Antitrust L. & Econ. Rev.* 105 (1971); see generally J. Kwoka & L. White, *The Antitrust Revolution* (1989).

n1045 See Section III.C.2., *supra*.

[\*3115] 500. While there is not unanimity on the proper definition of predatory pricing n1046 an examination of the opinions of academic commentators, the Supreme Court of the United States, parties to this proceeding, and others cited by the parties in the record of this proceeding, demonstrates that the question whether prices are below marginal cost, or its surrogate, average variable cost, is central to the determination of whether they are predatory. Disagreement exists on the point at which prices can be presumed legal, and on the role of intent in finding antitrust violations. n1047 In adopting average variable cost as a tariff review standard, we do not find that all rates which cover average variable costs are necessarily just and reasonable. Petitioners may be able to show that there is reason to investigate a rate decrease which we permit to go into effect after 45 days. Competitors can also file complaints alleging predatory pricing. In either case, it might be possible to show that the resulting rate is above average variable cost but nonetheless predatory using relevant antitrust analysis and precedent. n1048

n1046 See, e.g., *Further Notice*, 3 *FCC Rcd* at 3372, n.709, and cases cited therein; Areeda & Turner, *Predatory Pricing and Related Practices under Section 2 of the Sherman Act*, 88 *Harv. L. Rev.* 697 (1975); McGee, *Predatory Pricing Revisited*, 23 *J. Law & Econ.* 289 (1980); *Cargill Inc. v. Monfort of Colorado*, 479 U.S. 104, 117 n.12 (1986).

n1047 See *Cargill*, 479 U.S. at 117, n.12, comparing *Arthur S. Langenderfer, Inc. v. S. E. Johnson Co.*, 728 F.2d 1050, 1056-1057 (6th Cir.) cert. denied, 469 U.S. 1036 (1984), with *Transamerica Computer Co. v. International Business Machines Corp.*, 698 F.2d 1377 (9th Cir.), cert. denied, 464 U.S. 955 (1983).

n1048 Parties aggrieved by allegedly predatory pricing may also press their allegations in court under the antitrust laws.

501. The record in the instant proceeding does not provide us with a firm basis for specifying precisely what are the average variable costs of various telecommunications services. We do observe, however, that the average variable cost of any service must include all access charges and billing and collection

costs attributable to that service, as well as other non-fixed costs which would not be incurred if the service were not offered.

f. New and Restructured Services

i. Summary of Further Notice

502. In the Further Notice, we stated that new and restructured services present special considerations because of the opportunity they present to carriers to charge rates that otherwise would not be permitted under our price

[\*3116] cap rules. n1049 We found that while the offering of a new or restructured service potentially furthers our goal of increasing carrier innovation and cost-effectiveness, such an offering raises issues of rate discrimination as well as anticompetitive concerns. n1050 We tentatively concluded that it would be necessary to treat tariffs involving new and restructured services differently from tariffs that only specify rate level changes in order to discourage carriers from manipulating price cap regulation. n1051

n1049 3 FCC Rcd at 3320 (para. 232).

n1050 *Id.* at 3320-21 (para. 233).

n1051 *Id.* at 3321 (para. 234).

503. We tentatively concluded that an offering increasing customer options should be classified as new, while an offering that represents a change in an existing method of charging or provisioning, without increasing the range of alternatives, should be classified as restructured. n1052 We further concluded that new and restructured services presented different problems which required different treatment.

n1052 *Id.* at 3377 n.720 (para. 325).

504. We proposed that new services should initially be offered outside of price cap regulation, and incorporated into price caps in the first annual filing after the completion of the base year in which the service becomes effective. We tentatively concluded that carriers seeking to introduce a new service would be required to demonstrate that the service met a modified version of the "net revenue test" established in the Optional Calling Plan Order. n1053 We proposed that a new service must generate a net revenue increase within the lesser of the following time periods: 24 months after the effective date of the annual price cap tariff incorporating the new service, or 36 months from the date that the new tariff becomes effective. n1054 We tentatively concluded that the net revenue increase should be measured against revenues generated from services in the same price cap basket. n1055 In order

[\*3117] to afford adequate opportunity for review, we tentatively concluded that tariffs proposing new services should be filed on 45 days' notice. n1056

n1053 *Id.* at 3376 (para. 322) (citing Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans, CC Docket No. 84-1235, Memorandum Opinion and Order, 50 Fed. Reg. 42,945 (Oct. 23, 1985), 59 R.R.2d 70 (1985) (Optional

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Before the  
Federal Communications Commission  
Washington, D.C. 20554

CC Docket No. 92-141

In the Matter of

GTE Telephone Operating Companies

Investigation of Transmittal Nos. 711 and 750  
Below-band Transport Rates

# MEMORANDUM OPINION AND ORDER

Adopted: December 23, 1994; Released: December 29, 1994

By the Commission:

## I. BACKGROUND

1. In its 1992 annual access tariff filing, the GTE Telephone Operating Companies (GTE) filed substantially reduced below-band rates for transport service in several GTE study areas.<sup>1</sup> Below-band filings must be accompanied by a showing that the rates will cover average variable costs (AVC), and are otherwise just, reasonable, and nondiscriminatory.<sup>2</sup>

2. Some of GTE's below-band transport rates were lowered to a level at or near the average variable cost reported in its study. GTE's average variable cost showing, however, consisted only of summary results of incremental cost studies. Consequently, in the 1992 *Annual Access Order*,<sup>3</sup> the Common Carrier Bureau concluded that GTE failed to adequately support its below-band transport rates, and suspended those rates for five months pending an investigation to ensure that they were not predatory.<sup>4</sup>

3. In order to evaluate the reasonableness of GTE's filing, the Common Carrier Bureau directed GTE to file a direct case on July 27, 1992. In its direct case, GTE was instructed to: 1) provide the full incremental cost studies supporting its AVC showing results, e.g., the type and cost of equipment used to provide transport and the amount of usage of the equipment; and 2) demonstrate that its rates are just, reasonable and nondiscriminatory. In addition, the Bureau designated two issues for resolution: (1) whether GTE's below band rates are above GTE's average variable costs; and (2) whether GTE's rates are otherwise just, reasonable and nondiscriminatory. In its direct case, GTE provided AVC studies for California, Florida, Southwest and GTE of Washington/Oregon/California-West Coast.

GTE's direct case included four components: (i) summary workpapers combining the various cost sub-elements into the total investment required for each rate element; (ii) detail workpapers showing the material, engineering and installation costs of the equipment used to build each specified cost sub-element; (iii) workpapers representing the original summarized AVC results as filed in GTE's 1992 annual access filing; and (iv) return and income tax calculation workpapers. GTE maintains that the rate reductions at issue cover their average variable costs and are otherwise just, reasonable and nondiscriminatory. See GTE Direct Case at 11-15.

4. The Association for Local Telecommunications Services (ALTS) filed an opposition to GTE's direct case on August 17, 1992. ALTS first argues that in resolving the designated issues, the Commission must ensure that all variable costs associated with providing GTE's switched transport services are recovered through the appropriate rate elements. ALTS Opposition at 3. In order to capture a reasonable representation of a LEC's variable costs, ALTS contends, the Commission must take into account the accelerated levels of new investment in fiber optic facilities by considering cost data over a "reasonable" period of time. *Id.* at 4. ALTS therefore requests that the Commission clarify that the AVC test requires an averaging of LEC investment data over the most recent five-year period to account for distortions caused by "lumpy investment." *Id.* at i, 5.

5. In its reply to ALTS' opposition, filed August 24, 1992, GTE defends its rates as being a reasonable response to the competitive environment, and as fully consistent with the Commission's incentive regulation. GTE Reply at 2. See also GTE Direct Case at 14. According to GTE, it faces significant competition in the major metropolitan areas of Tampa, Los Angeles, Dallas and Seattle, and therefore appropriately selected these areas for rate reductions. *Id.* at 3.

6. GTE also defends the method it used to identify variable costs – the "snapshot" approach – which GTE defines as an analysis of cost structure and level (i.e., amount of copper/fiber) on a "present day/present snapshot in time" basis – as a reasonable, conservative approach for capturing average variable costs. *Id.* at 4-5. GTE maintains that it is an accepted economic standard to view incremental cost on a forward looking basis. *Id.* at 5. Likewise, GTE disagrees with ALTS' position that the Commission should average investment data over the most recent five-year period. GTE argues that there is no legal or academic precedent for ALTS' view, and that a five year historical perspective of costs suggests embedded cost studies and abandoned methodologies such as fully distributed cost. GTE contends that ALTS' position thus departs from the policy and direction of incentive regulation. *Id.*

7. ALTS next contends that the "extraordinary" cost differentials asserted by GTE among its various service areas "strongly indicate" that GTE's direct case

<sup>1</sup> GTE filed below-band rates for GTE California, GTE Florida, GTE Southwest and GTE Washington/Oregon/California-West-Coast. GTE Direct Case at 2.

<sup>2</sup> See Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6814, (para. 226) and 6824 (paras. 309-311) (1990) (*LEC Price Cap Order*);

Policy and Rules Concerning Rates for Dominant Carriers, Order on Reconsideration, 6 FCC Rcd 2637, 2699 (para. 137) (*LEC Price Cap Reconsideration Order*).

<sup>3</sup> 1992 Annual Access Tariff Filings, CC Docket No. 92-141, 7 FCC Rcd 4734 (1992) (1992 *Annual Access Order*).

<sup>4</sup> These below-band rates became effective on December 15, 1992.

underreports the relevant costs in the four service areas under investigation.<sup>5</sup> ALTS also contends that GTE underreported the costs associated with transport termination by excluding whole categories of relevant costs associated with monitoring and testing switched circuits, as well as spare equipment.<sup>6</sup> Additionally, ALTS contends, GTE excluded the costs of equipment racks, power supplies and fuse panels. ALTS Opposition at 9. ALTS states that the costs of billing and collection, recordkeeping, marketing and order processing were also excluded by GTE in direct violation of the Commission's price cap rules. *Id.* at 10-11.

8. GTE replies that its AVC study provided sufficient cost detail to justify the reasonableness of the costs involved, and that aggregation at the lowest levels is not necessary to describe adequately the variable costs involved. GTE Reply at 6. Further, GTE states, many of the items ALTS claims were excluded from GTE's study were included, but not necessarily shown at the lowest detail. *Id.* For example, GTE asserts, GTE included alarm equipment, equipment racks, power supplies and fuse panels in the "CO Repeater Equipment" category, and accounted for spare equipment in part through the 90 percent circuit equipment and 75 percent outside plant utilization factors. *Id.* at 7-8.

9. Further, GTE argues, it also properly included all relevant costs (e.g., capital costs) and has treated expenses such as marketing, order processing, billing and collection, record keeping and other administrative expenses correctly in determining average variable costs. *Id.* at 9-10. GTE indicates however, that it need not include billing and collection expenses because they are *de minimis*, and is not required to allocate these expenses to the specific rate elements GTE is proposing to change. *Id.* at 10.

10. ALTS also argues that GTE allocated the costs associated with its tandem offices entirely to switched transport termination when such costs should have been allocated to switched transport facility, since the function of tandem offices increases transport efficiency. ALTS Opposition at 10. Further, ALTS assails GTE's methodology for determining output as vague, in that the application of network usage factors is not clarified. ALTS complains that the output is never quantified, and the methodology overstates GTE's output. *Id.* at 11-12.

11. GTE defends its decision to assign tandem costs to transport termination, rather than to the transport facility. GTE maintains that Part 69 of the Commission's Rules does not require tandem costs to be included in the facility element of the transport category, and states that LECs have the latitude to place these costs in either category, or to spread costs across both services in whatever manner

reasonable. Since access tandem expenses are not distance sensitive, GTE asserts, it has placed these costs in transport termination. GTE Reply at 9. In challenging its method of determining output, GTE states, ALTS incorrectly assumed a 100 percent fill factor, when GTE used a 90 percent circuit equipment fill factor and 75 percent outside plant fill factor in the cost studies. GTE provides Exhibit 3 to illustrate its use of these fill factors. GTE asserts that the exhibit shows that it did not overstate output or understate cost. *Id.* at 12.

12. Finally, ALTS maintains, GTE's proposed rates are otherwise unreasonable because the 70-80 percent rate cuts proposed by GTE raise barriers to entry by inducing extraordinary volatility into the market, and creating regulatory uncertainty. ALTS Opposition at 15-16. GTE argues that its rates are otherwise just and reasonable because price reductions alone do not prove predatory prices and because the Commission's price cap rules and other regulatory constraints assure that the GTEs cannot abuse their position in the market.<sup>7</sup> GTE Reply at 12.

## II. DISCUSSION

13. In both the *AT&T Price Cap Order*<sup>8</sup> and the *LEC Price Cap Order* the Commission expressed the clear sentiment that rate reductions are generally beneficial to consumers, and are more often than not undertaken for competitive reasons.<sup>9</sup> Moreover, the Commission has maintained the view that proven cases of predatory pricing are rare, that below-band reductions introduced under our price cap system will more likely be pro-competitive than predatory, and that the LEC service basket structure further lessens the already unlikely occurrence of predation. In both the *AT&T Price Cap Order* and the *LEC Price Cap Order* the Commission found that average variable cost is central to determining whether prices are predatory for tariff review purposes.<sup>10</sup>

14. This investigation was prompted by a lack of clarity in GTE's cost support that prevented the Bureau from determining whether GTE's rates were so low as not to be just, reasonable and nondiscriminatory. Our decision in this investigation therefore needs to focus on whether those rates are predatory. In making this determination, we believe we should place great weight on whether GTE passes the average variable cost standard established in the price cap rules for tariff review of below band filings. That standard was designed as a check against predation, and is drawn from federal circuit court decisions in antitrust cases.<sup>11</sup>

<sup>5</sup> ALTS states that GTE's proposed premium transport termination charge for California would be set at 84 percent below GTE's Montana rates, 76 percent below its Michigan rates, 72 percent below its Illinois rates, and 55 percent below its Pennsylvania rates. *Id.* at 7.

<sup>6</sup> ALTS states that the combined cost of test and spare equipment is significant and attaches, as an example, a page from Illinois Bell's intrastate Optical Interconnection Service tariff, which shows that the total charges for its test and spare equipment amount to almost one-third of the entire variable cost GTE reports for a fiber-based special access line termination. *Id.* at i, 8-9.

<sup>7</sup> On September 30, 1992, ALTS filed a pleading captioned "Ex Parte Filing" responding to GTE's reply. GTE filed an opposi-

tion and motion to strike ALTS' pleading as unauthorized and untimely on October 5, 1992; ALTS filed an opposition to the motion to strike dated October 15, 1992. We will accept ALTS' filing as a permissible *ex parte* presentation. See 47 C.F.R. § 1.1206. Nothing in this filing leads us to reach a different result.

<sup>8</sup> Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice, 4 FCC Red 2873 (1989) and Erratum, 4 FCC Red 3379 (1989).

<sup>9</sup> See *AT&T Price Cap Order*, 4 FCC Red at 3114 (para. 499); *LEC Price Cap Order*, 5 FCC Red at 6824 (para. 309).

<sup>10</sup> See *AT&T Price Cap Order*, 4 FCC Red at 3114-15 (paras. 499-500); *LEC Price Cap Order*, 5 FCC Red at 6824 (paras. 309-311).

<sup>11</sup> *AT&T Price Cap Order* at 3114-3115.



15. In the price cap orders, the Commission specified certain types of costs which must be included in the calculation of the cost floor. The Commission stated that at a minimum, variable costs should include all access charges and billing and collection costs attributable to the service, as well as other non-fixed costs which would not be incurred if the service were not offered.<sup>12</sup> AVC showings submitted in the past<sup>13</sup> have had the following characteristics: (1) for the service in question, the unit costs of plant investment,<sup>14</sup> network maintenance and operations, and customer operations, as well as other costs specified in the price cap orders, were included in the calculation of the cost floor; and (2) such costs were "forward-looking," i.e., costs that a new service provider seeking to offer ongoing service for a reasonable duration would face in the market today. Forward-looking costs are based on current and anticipated prices, not embedded costs, and are based on a service configuration embodying state of the art technology.<sup>15</sup>

16. GTE has developed its costs using a method similar to that outlined above.<sup>16</sup> One major difference is that GTE used a "snapshot" approach to capture the costs of its current network, thereby including more embedded (copper) facilities than would be included if the transport facility were built today. Since the cost of copper facilities exceeds that of fiber optic facilities which would predominate in the future, calculations more heavily weighted toward copper result in a higher AVC cost floor than under the method outlined above. Since GTE can show that its prices exceed the higher AVC cost floor, GTE's variation in method does not invalidate its AVC showing.<sup>17</sup> Another difference is that contrary to the Commission's direction in the *AT&T Price Cap Order*, GTE did not include billing and collection costs in the rate elements it proposes modifying. GTE has recalculated its AVC including billing and collection costs and has shown that in each study area except for Florida its proposed rates exceed AVC.<sup>18</sup> GTE has refiled its Florida rates to raise them above the recalculated AVC.<sup>19</sup>

17. GTE has demonstrated that its costs meet or exceed its average variable cost, and has thus made the showing required for below-band rates. GTE has also adequately addressed ALTS' allegations that GTE underreported costs and overestimated service output.<sup>20</sup> In addition, there is nothing else in the record to support a conclusion that

GTE's rates are otherwise unreasonable or unreasonably discriminatory. Accordingly, we find that GTE's rates are lawful.

### III. ORDERING CLAUSES

18. Accordingly, IT IS ORDERED that the investigation of GTE's below band transport rates initiated by the Common Carrier Bureau in the 1992 *Annual Access Order* IS TERMINATED.

19. IT IS FURTHER ORDERED that GTE's motion to strike ALTS' "Ex Parte Filing" IS DENIED.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton  
Acting Secretary

<sup>12</sup> See e.g., *AT&T Price Cap Order*, 4 FCC Rcd at 3115 (1989).

<sup>13</sup> See e.g., AT&T Communications Tariff F.C.C. No. 1, Transmittal No. 2777, effective January 1, 1991; AT&T Communications Tariff F.C.C. No. 1, Transmittal No. 2717, effective December 30, 1990; and AT&T Communications Tariff F.C.C. No. 1, Transmittal No. 2661, effective December 8, 1991.

<sup>14</sup> Such costs would include "capital costs," i.e., depreciation expense, net return, and relevant taxes. See Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, Vol. 1 at 32-36 (1970).

<sup>15</sup> "For it is current and anticipated cost, rather than historical cost, that is relevant to business decisions to enter markets and price products. . . . The historical costs associated with the plant already in place are essentially irrelevant to this decision since those costs are 'sunk' and unavoidable and are unaffected by a new production decision." *MCI Communications Corporation v. American Telephone and Telegraph Company*, 708 F.2d 1081,

1116-17 (7th Cir. 1983). For this reason, we reject ALTS' suggestion that a LEC average its investment over the most recent five year period.

<sup>16</sup> GTE provided its billing and collection costs for the affected switched access rates in an *Ex Parte* letter filed October 21, 1992.

<sup>17</sup> We note that GTE made a number of assumptions (such as average distance of the transport facility and the rounding up of the percent of fiber) which have the effect of lowering the reported average variable cost. In general, however, it appears that the effect of these assumptions is more than offset by the overall conservative nature of GTE's study methodology (e.g., the inclusion of copper facilities in determining the cost of its network).

<sup>18</sup> See note 15, *infra*, C.

<sup>19</sup> GTE Tariff F.C.C. No. 1, Transmittal No. 750, filed October 30, 1992. These rates became effective December 15, 1992.

<sup>20</sup> See paras. 8, 9, and 11 *supra*.

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FCC 96-325

**Before the  
Federal Communications Commission  
Washington, DC 20554**

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications Act	)	
of 1996	)	
	)	
Interconnection between Local Exchange	)	CC Docket No. 95-185
Carriers and Commercial Mobile Radio	)	
Service Providers	)	
	)	

**FIRST REPORT AND ORDER**

Adopted: August 1, 1996

Released: August 8, 1996

By the Commission: Chairman Hundt and Commissioners Quello, Ness, and Chong issuing separate statements.

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displaced facilities for other purposes. Overall, we think that these factors can and should be captured in any LRIC model and therefore we do not agree that this requires a departure from the general principle of forward-looking cost-based pricing for network elements.

688. We are not persuaded by USTA's argument that forward looking methodologies fail to adjust the cost of capital to reflect the risks associated with irreversible investments and that they are "biased downward by a factor of three." First, USTA's argument unrealistically assumes that competitive entry would be instantaneous. The more reasonable assumption of entry occurring over time will reduce the costs associated with sunk investment. Second, we find it unlikely that investment in communications equipment is entirely irreversible or that such equipment would become valueless once facilities-based competition begins. In a growing market, there most likely would be demand for at least some embedded telecommunications equipment, which would therefore retain its value. Third, contractual arrangements between the new entrant and the incumbent that specifically address USTA's concerns and protect incumbent's investments during transition can be established.

689. Finally we are not persuaded that the use by firms of hurdle rates that exceed the market cost of capital is convincing evidence that sunk investments significantly increase a firm's cost of capital. An alternative explanation for this phenomenon is that the process that firms use to choose among investment projects results in overestimates of their returns. Firms therefore use hurdle rates in excess of the market cost of capital to account for these overestimates.<sup>1692</sup>

690. *Summary of TELRIC Methodology.* The following summarizes our conclusions regarding setting prices of interconnection and access to unbundled network elements based on the TELRIC methodology for such elements. The increment that forms the basis for a TELRIC study shall be the entire quantity of the network element provided. As we have previously stated, all costs associated with the providing the element shall be included in the incremental cost. Only forward-looking, incremental costs shall be included in a TELRIC study. Costs must be based on the incumbent LEC's existing wire center locations and most efficient technology available.

691. Any function necessary to produce a network element must have an associated cost. The study must explain with specificity why and how specific functions are necessary to provide network elements and how the associated costs were developed. Only those costs that are incurred in the provision of the network elements in the long run shall be directly

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<sup>1692</sup> See Richard Thaler, *The Winner's Curse*, 2 J. Econ. Perspectives 201 (1988); Keith Brown, *Note on the Apparent Bias of Net Revenue Estimates for Capital Investment Projects*, 29 J. Fin. 1215-16 (1974); Daniel Kahneman and Daniel Lovallo, *Timid Choices, Bold Forecasts*, 39 Management Science 17, 28 (1993). In addition, we note that Hausman's arguments that TSLRIC method underestimate the true cost of an element apply only to the capital expense associated with an element and not to the operating expense.

attributable to those elements. Costs must be attributed on a cost-causative basis. Costs are causally-related to the network element being provided if the costs are incurred as a direct result of providing the network elements, or can be avoided, in the long run, when the company ceases to provide them. Thus, for example, the forward-looking costs of capital (debt and equity) needed to support investments required to produce a given element shall be included in the forward-looking direct cost of that element. Directly attributable costs shall include costs such as certain administrative expenses, which have traditionally been viewed as common costs, if these costs vary with the provision of network elements. Retailing costs, such as marketing or consumer billing costs associated with retail services, are not attributable to the production of network elements that are offered to interconnecting carriers and must not be included in the forward-looking direct cost of an element.

692. In a TELRIC methodology, the "long run" used shall be a period long enough that all costs are treated as variable and avoidable.<sup>1693</sup> This "long run" approach ensures that rates recover not only the operating costs that vary in the short run, but also fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element.

693. States may review a TELRIC economic cost study in the context of a particular arbitration proceeding, or they may conduct such studies in a rulemaking and apply the results in various arbitrations involving incumbent LECs. In the latter case, states must replace any interim rates<sup>1694</sup> set in arbitration proceedings with the permanent rate resulting from the separate rulemaking. This permanent rate will take effect at or about the time of the conclusion of the separate rulemaking and will apply from that time forward.

694. *Forward-Looking Common Costs.* Certain common costs are incurred in the provision of network elements. As discussed above, some of these costs are common to only a subset of the elements or services provided by incumbent LECs. Such costs shall be allocated to that subset, and should then be allocated among the individual elements or services in that subset, to the greatest possible extent. For example, shared maintenance facilities and vehicles should be allocated only to the elements that benefit from those facilities and vehicles. Common costs also include costs incurred by the firm's operations as a whole, that are common to all services and elements (e.g., salaries of executives involved in overseeing all activities of the business), although for the purpose of pricing interconnection and access to unbundled elements, which are intermediate products offered to competing carriers, the relevant common costs do not include billing, marketing, and other costs

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<sup>1693</sup> See 1 Alfred E. Kahn *The Economics of Regulation: Principles and Institutions* 70-71 (1988).

<sup>1694</sup> See *infra*, Section VII.C., discussing default proxy price ceilings and ranges.

attributable to the provision of retail service.<sup>1695</sup> Given these common costs, setting the price of each discrete network element based solely on the forward-looking incremental costs directly attributable to the production of individual elements will not recover the total forward-looking costs of operating the wholesale network.<sup>1696</sup> Because forward-looking common costs are consistent with our forward-looking, economic cost paradigm, a reasonable measure of such costs shall be included in the prices for interconnection and access to network elements.

695. The incumbent LECs generally argue that common costs are quite significant,<sup>1697</sup> while several other parties maintain that these amounts are minimal.<sup>1698</sup> Because the unbundled network elements correspond, to a great extent, to discrete network facilities, and have different operating characteristics, we expect that common costs should be smaller than the common costs associated with the long-run incremental cost of a service. We expect that many facility costs that may be common with respect to the individual services provided by the facilities can be directly attributed to the facilities when offered as unbundled network elements. Moreover, defining the network elements at a relatively high level of aggregation, as we have done,<sup>1699</sup> should also reduce the magnitude of the common costs. A properly conducted TELRIC methodology will attribute costs to specific elements to the greatest possible extent, which will reduce the common costs. Nevertheless, there will remain some common costs that must be allocated among network elements and interconnection services. For example, at the sub-element level of study (*e.g.*, identifying the respective costs of 2-wire loops, 4-wire loops, ISDN loops, and so on), common costs may be a significant proportion of all the costs that must be recovered from sub-elements. Given the likely asymmetry of information regarding network costs, we conclude that, in the arbitration process, incumbent LECs shall have the burden to prove the specific nature and magnitude of these forward-looking common costs.

696. We conclude that forward-looking common costs shall be allocated among elements and services in a reasonable manner, consistent with the pro-competitive goals of the

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<sup>1695</sup> See *infra*, Section VIII.B., describing "avoided costs" in the resale context.

<sup>1696</sup> See, *e.g.*, AT&T comments at 61-66; Teleport comments at 47-48.

<sup>1697</sup> See, *e.g.*, PacTel reply at 27-28; see also Cincinnati Bell reply at 10; USTA comments at Attachment 1 (Affidavit of Jerry A. Hausman), p.4 n.1.

<sup>1698</sup> See, *e.g.*, Competition Policy Institute comments at 19; MCI comments at 66; Texas Public Utility Counsel comments at 24.

<sup>1699</sup> See *supra*, Section V., discussing unbundling requirements.

1996 Act. One reasonable allocation method would be to allocate common costs using a fixed allocator, such as a percentage markup over the directly attributable forward-looking costs. We conclude that a second reasonable allocation method would allocate only a relatively small share of common costs to certain critical network elements, such as the local loop and collocation, that are most difficult for entrants to replicate promptly (*i.e.*, bottleneck facilities). Allocation of common costs on this basis ensures that the prices of network elements that are least likely to be subject to competition are not artificially inflated by a large allocation of common costs. On the other hand, certain other allocation methods would not be reasonable. For example, we conclude that an allocation methodology that relies exclusively on allocating common costs in inverse proportion to the sensitivity of demand for various network elements and services may not be used.<sup>1700</sup> We conclude that such an allocation could unreasonably limit the extent of entry into local exchange markets by allocating more costs to, and thus raising the prices of, the most critical bottleneck inputs, the demand for which tends to be relatively inelastic. Such an allocation of these costs would undermine the pro-competitive objectives of the 1996 Act.

697. We believe that our treatment of forward-looking common costs will minimize regulatory burdens and economic impact for all parties involved in arbitration of agreements for interconnection and access to unbundled elements, and will advance the 1996 Act's pro-competitive objectives for local exchange and exchange access markets.<sup>1701</sup> In our decisionmaking, we have considered the economic impact of our rules in this section on small incumbent LECs. For example, although opposed to the use of a forward-looking, economic cost methodology, small incumbent LECs favor the recovery of joint and common costs in the event the Commission adopts forward-looking cost methodology. We are adopting such an approach. Moreover, the cost-based pricing methodology that we are adopting is designed to permit incumbent LECs to recover their economic costs of providing interconnection and unbundled elements, which may minimize the economic impact of our decisions on incumbent LECs, including small incumbent LECs. We also note that certain small incumbent LECs are not subject to our rules under section 251(f)(1) of the 1996 Act, unless otherwise determined by a state commission, and certain other small incumbent LECs may seek relief from their state commissions from our rules under section 251(f)(2) of the 1996 Act.<sup>1702</sup>

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<sup>1700</sup> See Frank P. Ramsey, *A Contribution to the Theory of Taxation*, 37 Econ. J. 47 (1927); see generally Kenneth E. Train, *Optimal Regulation: The Economic Theory of Natural Monopoly* 115-40 (1992) (discussing efficiency properties of Ramsey prices); Bridger M. Mitchell & Ingo Vogelsang, *Telecommunications Pricing: Theory and Practice* 43-61 (1991). The sensitivity of demand is measured by the elasticity of demand, which is defined as the percentage change in the quantity of a service demanded for a one per cent change in price.

<sup>1701</sup> See Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

<sup>1702</sup> 47 U.S.C. § 251(f).

698. We further conclude that, for the aggregate of all unbundled network elements, incumbent LECs must be given a reasonable opportunity to recover their forward-looking common costs attributable to operating the wholesale network. In no instance should prices exceed the stand-alone cost for a specific element, and in most cases they should be below stand-alone costs. Stand-alone costs are defined as the forward-looking cost that an efficient entrant would incur in providing a given element or any combination of elements. No price higher than stand-alone cost could be sustained in a market from which entry barriers were completely absent. Where there are few common costs, there is likely to be only a minimal difference between the forward-looking costs that are directly attributable to the particular element, which excludes these costs, and stand-alone cost, which includes all of them. Network elements should not, however, be priced at levels that would enable the incumbent LEC to recover the same common costs multiple times from different elements. Any multiple recovery would be unreasonable and thus in violation of the statutory standard. Further, we note that the sum of the direct costs and the forward-looking common costs of all elements will likely differ from the incumbent LEC's historical, fully distributed costs.

699. *Reasonable Return on Investment and "Profit."* Section 252(d)(1) states that rates for interconnection and access to unbundled elements "may include a reasonable profit."<sup>1703</sup> We find that the TELRIC pricing methodology we are adopting provides for such a reasonable profit and thus no additional profit is justified under the statutory language. We note there are two types of profit. First, in plain English, profit is defined as "the excess of returns over expenditure in a transaction or a series of transactions."<sup>1704</sup> This is also known as a "normal" profit, which is the total revenue required to cover all of the costs of a firm, including its opportunity costs.<sup>1705</sup> Second, there is "economic" profit, which is any return in excess of normal profit.<sup>1706</sup> Thus, for example, if the normal return in an industry is 10 percent and a firm earns a return of 14 percent, the economic profit for that firm is 4 percent. Economic is also referred to as "supranormal" profit. We conclude that the definition of "normal" profit is embodied in "reasonable profit" under Section 252(d)(1).

700. The concept of normal profit is embodied in forward-looking costs because the forward-looking cost of capital, *i.e.*, the cost of obtaining debt and equity financing, is one of the forward-looking costs of providing the network elements. This forward-looking cost of capital is equal to a normal profit. We conclude that allowing greater than normal profits

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<sup>1703</sup> 47 U.S.C. § 252(d)(1).

<sup>1704</sup> *Webster's New Collegiate Dictionary* 931 (10th ed. 1994).

<sup>1705</sup> See David W. Pearce, *The MIT Dictionary of Modern Economics* (1994) at 310.

<sup>1706</sup> *Id.* at 415.



would not be "reasonable" under sections 251(c) and 252(d)(1).<sup>1707</sup> Thus, contrary to the arguments put forth by several incumbent LECs, we find that adding an additional measure of profit to the risk-adjusted cost of capital<sup>1708</sup> in setting the prices for interconnection and access to unbundled elements would violate the requirements of sections 251(c) and 252(d)(1) of the 1996 Act.

701. Possible accounting losses from the sale of interconnection and unbundled network elements using a reasonable forward-looking cost-based methodology do not necessarily indicate that incumbent LECs are being denied a "reasonable profit" under the statute. The use of a forward-looking, economic, cost-based pricing methodology, including a reasonable allocation of legitimate joint and common costs, will permit incumbent LECs the opportunity to earn a reasonable return on their investment in network elements. Finally, contrary to PacTel's argument, and as discussed below in detail, we conclude that our forward-looking cost-based pricing methodology is consistent with the Fifth Amendment and is not confiscatory.

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<sup>1707</sup> We note that our interpretation is consistent with existing Supreme Court precedent concerning what constitutes a reasonable rate of return for a regulated public utility. For example, in *Bluefield Water Works*, the Court stated:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.

*Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679, 692-93 (1923). Similarly, in *FPC v. Hope Natural Gas*, the Court stated:

... it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock . . . By that standard the return to the equity owner should be commensurate with risks on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

*Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope Natural Gas*). Cf., Charles F. Phillips, Jr., *The Economics of Regulation* 260 (Rev. ed. 1965) ("... a regulated company must be afforded the opportunity not only of assuring its financial integrity so that it can maintain its credit standing and attract additional capital as needed, but also for earnings comparable to those of other companies having corresponding risks.").

<sup>1708</sup> See *supra*, this Section, for a discussion of risk-adjusted cost of capital.

702. Based on the current record, we conclude that the currently authorized rate of return at the federal or state level is a reasonable starting point for TELRIC calculations, and incumbent LECs bear the burden of demonstrating with specificity that the business risks that they face in providing unbundled network elements and interconnection services would justify a different risk-adjusted cost of capital or depreciation rate. These elements generally are bottleneck, monopoly services that do not now face significant competition. We recognize that incumbent LECs are likely to face increased risks given the overall increases in competition in this industry, which generally might warrant an increased cost of capital, but note that, earlier this year, we instituted a preliminary inquiry as to whether the currently authorized federal 11.25 percent rate of return is too high given the current marketplace cost of equity and debt.<sup>1709</sup> On the basis of the current record, we decline to engage in a time-consuming examination to determine a new rate of return, which may well require a detailed proceeding. States may adjust the cost of capital if a party demonstrates to a state commission that either a higher or lower level of cost of capital is warranted, without that commission conducting a "rate-of-return or other rate based proceeding."<sup>1710</sup> We note that the risk-adjusted cost of capital need not be uniform for all elements. We intend to re-examine the issue of the appropriate risk-adjusted cost of capital on an ongoing basis, particularly in light of the state commissions' experiences in addressing this issue in specific situations.

703. We disagree with the conclusion that, when there are mostly sunk costs, forward-looking economic costs should not be the basis for pricing interconnection elements. The TELRIC of an element has three components, the operating expenses, the depreciation cost,<sup>1711</sup> and the appropriate risk-adjusted cost of capital. We conclude that an appropriate calculation of TELRIC will include a depreciation rate that reflects the true changes in economic value of an asset and a cost of capital that appropriately reflects the risks incurred by an investor. Thus, even in the presence of sunk costs, TELRIC-based prices are an appropriate pricing methodology.

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<sup>1709</sup> See *Common Carrier Bureau Sets Pleading Schedule in Preliminary Rate of Return Inquiry*, Public Notice, 11 FCC Rcd 3651 (Com. Car. Bur. 1996).

<sup>1710</sup> 47 U.S.C. § 252(d)(1)(A)(i).

<sup>1711</sup> Depreciation is the method of recognizing as an expense the cost of a capital investment. Properly calculated economic depreciation is a periodic reduction in the book value of an asset that makes the book value equal to its economic or market value.

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## EX PARTE OR LATE FILED

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1020 Nineteenth Street NW  
Suite 700  
Washington, DC 20036  
202 429-3120  
fax: 202 293-0561

Melissa Newman  
Executive Director - Federal Regulatory

**USWEST****RECEIVED**

APR 08 1999

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARYEX PARTE

April 7, 1999

Tamara Preiss, Esquire  
Competitive Pricing Division  
Common Carrier Bureau  
Federal Communications Commission  
445 - 12<sup>th</sup> Street, SW, Room 5A207  
Washington, DC 20554

Re: Petition of U S WEST Communications, Inc. for Forbearance  
from Regulation as a Dominant Carrier for High Capacity Services  
in the Phoenix, Arizona MSA, CC Docket No. 98-157

Petition of U S WEST Communications, Inc. for Forbearance from  
Regulation as a Dominant Carrier for High Capacity Services in the  
Seattle, Washington MSA, CC Docket No. 99-1

Dear Ms. Preiss:

Over the last couple of months various representatives of U S WEST have met with you and other Federal Communications Commission ("Commission") Staff to discuss U S WEST Communications, Inc.'s ("U S WEST") petitions requesting that the Commission forbear from regulating it as a dominant provider of high capacity (i.e., DS1 and above) special access and dedicated transport for switched access services ("high capacity services") in the Phoenix, Arizona and Seattle, Washington MSAs filed on August 24, 1998 and December 30, 1998, respectively. In those meetings, several questions arose with respect to the petitions and the level of regulation that U S WEST faces in Arizona and Washington. U S WEST was asked to submit additional information in order to assist the Commission Staff in evaluating U S WEST's requests for regulatory relief. This letter is an effort to continue to respond to the Staff's information requests. Additional information will be submitted as soon as it is available.

Tamara Preiss, Esquire  
April 7, 1999  
Page 2

I have enclosed the following attachments to assist the Staff in its review:

- Attachment 1 shows representative situations where U S WEST was able to participate in intrastate competitive bid situations due to the flexibility afforded by the states.
- Attachment 2 analyzes the revenue potential within 100 feet of the competitive fiber. This revenue potential is very attractive to competitors.
- Attachment 3 provides an assessment of the interstate pricing history for high capacity services. Because it had very low prices U S WEST made use of volume and term discounts in lieu of lowering rates or using zone pricing.
- Attachment 4 shows the Arizona and Washington UNE prices.
- Attachment 5 shows the intrastate pricing history for DS1 and DS3 services in Arizona and Washington.

Acknowledgment and date of receipt of this transmittal are requested. A duplicate of this letter is attached for this purpose.

Please call if you have any questions.

Sincerely,

*Melissa Neuman*

Attachments

**U S WEST**  
**High Capacity Forbearance**

**Attachment 1**

**Intrastate Contracting Capability**

One of the major benefits for customers from the forbearance U S WEST is seeking in Phoenix and Seattle is the ability to make competitive bids and enter into contracts. Representative examples of opportunities in which U S WEST was able to participate and give the customer additional competitive choices were:

January 1997	A State of Washington K-20 Educational Telecommunications Network bid for DS1 and DS3. Competitors included AT&T and MCI.
January 1999	State of Oregon bid for Centrex, Analog Voice Grade and DS1. Competitors included AT&T and GTE.
November 1998	State of Arizona (state agencies, hospitals and schools) bid for DSS, Analog, and DS1. Competitive bids were involved.
February 1999	Utah Education Network requested bids for DS1, DS3, SST and SRS services. To compete with AT&T and MCI WorldCom, U S WEST proposed a service package that offered the customer more favorable terms and conditions.

Intrastate contracts typically can be negotiated on an Individual Case Basis without filing associated tariffs. Margin requirements, strategic fit and competitive forces drive the pricing and packaging decisions. Intrastate agreements provide U S WEST the flexibility it needs to customize the bid to best meet the need of customer.

**U S WEST**  
**High Capacity Forbearance**

**Attachment 2**

**Revenue Potential within 100 Feet**

In response to a question regarding the attraction for CLECs/CAPs to extend their service to customers within 100 feet of their fibers in the Phoenix MSA, the revenue potential is estimated to be \$30 million per year for the revenues from just the High Capacity services. If all of the potential revenues (e.g., local, toll, custom calling, etc.) are included the revenue raises to approximately \$50 million per year. These revenue estimates are not precise but do give an idea that the customers within 100 feet of the competitive fibers are a very attractive segment of the market.

When these revenue numbers are compared to the estimated cost to construct, which is \$28 million from the POWER model for locations within 100 feet; the situation is very attractive for the competitors to try to capture as much of this business as possible. The respective investment per revenue ratio is below unity (28/50). As explained in the Kahn and Tardiff paper attached to the Phoenix petition, ratios this small are much less than the overall ratio (3.2) which USWC has for Arizona and are very indicative of a very attractive market.

If the competitors are able to attract only a portion the business, say 50 % (\$15 million) of just the High Capacity services; the ratio is two (28/15), still less than the existing USWC ratio. Customers within 100 feet of the competitive fiber comprise a very attractive opportunity.

**U S WEST**  
**High Capacity Forbearance**

**Attachment 3**

**Interstate Prices**

For the last few years the month-to-month prices for the various interstate DS1 and DS3 services have essentially remained flat. The headroom that was present in the early nineties has evaporated with the ever-increasing productivity factor. In the early stages of Price Caps, U S WEST had some of the lowest prices<sup>1</sup> for High Capacity services among the ILECs. Considering that competitors were pricing 15-to 20% below U S WEST (umbrella pricing), U S WEST did not see the benefit of lowering monthly prices further. During this time, U S WEST continued to tariff several volume and term plans which gave the benefit of lower prices in exchange for the commitment to purchase a number of services over a specific period of time. Volume and term discounts are as high as 20%. Through these volume and term plans, the net price for the services has declined.

Because volume and term plans are initially tariffed as new services under the Price Cap rules, they do not generate headroom. They are initially filed outside of Price Caps and then come under Price Caps at the Annual Filing following the year in which they were tariffed. When they come under Price Caps, they come in as new rate elements, not as reduced rates for existing rate elements. The customers receive the benefit of the volume and term prices but headroom is not generated under the Price Cap formulas.

U S WEST has made limited use of zone pricing, but found it to be of limited benefit in a competitive environment. Competition does not develop uniformly across a zone. Competitors target key customers and buildings that exhibit the greatest revenue potential. The current zone density pricing rules do not allow U S WEST to address specific customer needs for customized pricing or to respond to initiatives of competitors.

<sup>1</sup> Even after Price Caps had existed for awhile, USW still had some of the lowest rates. Of the eight largest ILECs (Ameritech, Bell Atlantic, Bell South, NYNEX, Pacific Bell, GTE and USW) a comparison of the rates from the 1997 Annual Filing shows:

<u>Rate element</u>	<u>Range of rates</u>	<u>USW rate</u>	<u>Average rate</u>
DS1 Chan Term	\$325 to \$115	\$115	\$185
DS1 Mux	\$418 to \$180	\$218	\$250
DS1 Fix Mileage 0-8	\$90 to \$35	\$87	\$64
DS1 Var Mileage 0-8	\$25 to \$5	\$14	\$17
DS1 CT, Mux, 1 Mile	\$704 to \$409	\$433	\$515
DS3 Chan Term	\$3080 to \$1150	\$1350	\$1969
DS3 Mux	\$950 to \$115	\$255	\$500
DS3 Fix Mileage 0-8	\$1500 to \$263	\$310	\$671
DS3 Var Mileage 0-8	\$200 to \$27	\$43	\$114
DS3 CT, Mux, 1 Mile	\$4685 to \$1834	\$1958	\$3255



**U S WEST  
High Capacity Forbearance**

Attachment 4

**State UNE Pricing**

Arizona:

	<u>Monthly Fixed</u>	<u>Monthly Per Mile</u>	<u>Non-Recurring</u>
<b>Unbundled Dedicated Interoffice Transport (UDIT)</b>			
DS1 UDIT			\$302.91
DS1 0 to 8 Miles	\$35.98	\$0.65	
DS1 Over 8 to 25 Miles	\$35.99	\$0.94	
DS1 Over 25 to 50 Miles	\$36.00	\$1.75	
DS1 Over 50 Miles	\$36.00	\$1.59	
 DS3 UDIT			 \$302.91
DS3 0 to 8 Miles	\$243.17	\$13.32	
DS3 Over 8 to 25 Miles	\$246.15	\$15.90	
DS3 Over 25 to 50 Miles	\$250.66	\$22.91	
DS3 Over 50 Miles	\$249.26	\$22.49	
 <b>Entrance Facilities</b>			
DS1	\$89.42		\$256.87
DS3	\$357.16		\$256.87
 <b>Multiplexing</b>			
DS3 to DS1	\$196.85		\$2,281.44
DS1 to DS0	\$200.08		\$230.93
DS1/DS0 Low Side Channelization	\$6.08		\$231.47
 <b>Unbundled Network Elements (UNEs)</b>			
4-Wire Non-Loaded Loop	\$22.90		varies by installation option
DS1 Capable Loop	\$89.42		varies by installation option

**U S WEST**  
**High Capacity Forbearance**

Attachment 4

**State UNE Pricing**

Washington:

**Unbundled Dedicated  
Interoffice Transport (UDIT)**

**DS1 UDIT**

DS1 0 to 8 Miles

\$39.08

\$0.60

under development

DS1 Over 8 to 25 Miles

\$39.08

\$0.76

DS1 Over 25 to 50 Miles

\$39.10

\$2.72

DS1 Over 50 Miles

\$39.10

\$3.19

**DS3 UDIT**

DS3 0 to 8 Miles

\$265.17

\$12.51

under development

DS3 Over 8 to 25 Miles

\$265.98

\$13.63

DS3 Over 25 to 50 Miles

\$272.68

\$35.81

DS3 Over 50 Miles

\$275.10

\$40.95

**Multiplexing**

DS3 to DS1

\$200.70

\$304.78

DS1 to DS0

\$206.78

\$297.13

DS1/DS0 Low Side Channelization

under development

**Unbundled Network  
Elements (UNEs)**

4-Wire Non-Loaded Loop

\$41.93

varies by installation option

DS1 Capable Loop

\$90.50

varies by installation option

**U S WEST**  
**High Capacity Forbearance**  
**State Pricing History**

**Attachment 5**

**DS1 - Washington**

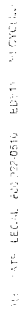
4/1/89		6/25/1993 to Present							
		M-T-M	1-yr	2-yr	3-yr	4-yr	5-yr	6-yr	7-yr
NAC or CT	199.95	150.00	150.00	141.00	133.95	126.90	119.85	109.98	108.58
Mileage:									
Fixed 0-8	269.45	73.86	73.86	73.86	73.86	73.86	73.86	73.86	73.86
Per Mi 0-8	11.00	2.04	2.04	2.04	2.04	2.04	2.04	2.04	2.04
Fixed 8-25	283.05	74.22	74.22	74.22	74.22	74.22	74.22	74.22	74.22
Per Mi 8-25	11.40	2.86	2.86	2.86	2.86	2.86	2.86	2.86	2.86
Fixed 25-50	305.95	74.81	74.81	74.81	74.81	74.81	74.81	74.81	74.81
Per Mi 25-50	12.00	2.65	2.65	2.65	2.65	2.65	2.65	2.65	2.65
Fixed >50	400.70	77.43	77.43	77.43	77.43	77.43	77.43	77.43	77.43
Per Mi >50	14.65	2.86	2.86	2.86	2.86	2.86	2.86	2.86	2.86
Term Discount									
1-Year	15%								
3-Years	20%								
5-Years	20%								

**DS1 - Arizona**

<u>4/1/89</u>		<u>6/25/1993 to Present</u>							
		<u>M-T-M</u>	<u>1-yr</u>	<u>2-yr</u>	<u>3-yr</u>	<u>4-yr</u>	<u>5-yr</u>	<u>6-yr</u>	<u>7-yr</u>
NAC or CT	189.95	150.00	141.00	133.95	126.90	119.85	109.98	109.28	108.57
Mileage:									
Fixed 0-8	269.45	150.00	141.00	133.95	126.90	119.85	109.98	109.28	108.57
Per Mi 0-8	11.00	11.00	10.25	9.74	9.23	8.71	8.00	7.94	7.89
Fixed 8-25	283.05	200.00	179.50	170.53	161.55	152.58	140.01	139.11	138.22
Per Mi 8-25	11.40	15.00	14.10	13.40	12.69	11.99	11.00	10.93	10.86
Fixed 25-50	305.95	250.00	218.00	207.10	196.20	185.30	170.04	168.95	167.86
Per Mi 25-50	12.00	17.00	16.65	15.82	14.99	14.15	12.99	12.90	12.82
Fixed >50	400.70	250.00	218.00	207.10	196.20	185.30	170.04	168.95	167.86
Per Mi >50	14.65	17.00	16.65	15.82	14.99	14.15	12.99	12.90	12.82
Term Discount									
1-Year	15%								
3-Years	20%								
5-Years	20%								

**DS3 - Arizona and Washington**

		6/25/1993 to Present							
	4/1/89	M-T-M	1-yr	2-yr	3-yr	4-yr	5-yr	6-yr	7-yr
NAC(Cap of 1)	1,400.00	1,282.50	1,244.03	1,205.55	1,154.25	1,090.13	1,026.00	993.94	961.88
Mileage:									
Fixed 0-8	625.48	590.90	573.17	555.45	531.81	502.27	472.72	457.95	443.18
Per Mi 0-8	34.44	51.26	49.89	48.18	46.13	43.74	41.00	39.64	38.61
Fixed 8-25	628.56	593.75	575.94	558.13	534.38	504.69	475.00	460.16	445.31
Per Mi 8-25	36.92	35.15	34.10	33.04	31.46	29.88	28.12	27.24	26.36
Fixed 25-50	633.72	598.50	580.55	562.59	538.65	508.73	478.80	463.84	448.88
Per Mi 25-50	41.10	51.11	49.74	48.04	45.99	43.61	40.88	39.52	38.50
Fixed >50	655.14	619.40	600.82	582.24	557.46	526.49	495.52	480.04	464.55
Per Mi >50	58.41	57.92	56.37	54.44	52.12	49.42	46.33	44.79	43.63
Term Discount									
1-Year	15%								
3-Years	20%								
5-Years	20%								



**REGULATIONS, RATES AND CHARGES**

Applying to the provision of Access Services  
within a Local Access and Transport Area (LATA)  
or equivalent market areas for  
Connection to Interstate Communications Facilities  
for Customers within the operating territory of

**U S WEST Communications, Inc.**  
in the State(s) of  
Arizona (AZ) (Company Code [CC] 5101)  
Colorado (CO) (CC 5102)  
Idaho (ID - Boise LATA) (CC 5103)  
Idaho (ID - Spokane LATA) (CC 5162)  
Iowa (IA) (CC 5141)  
Minnesota (MN) (CC 5142)  
Montana (MT) (CC 5104)  
Nebraska (NE) (CC 5143)  
New Mexico (NM) (CC 5105)  
North Dakota (ND) (CC 5144)  
Oregon (OR) (CC 5163)  
South Dakota (SD) (CC 5145)  
Utah (UT) (CC 5107)  
Washington (WA) (CC 5161)  
Wyoming (WY) (CC 5108)

(C)

(C)

as provided herein

d/b/a  
U S WEST Communications[1]

(T)

Original tariff effective July 27, 1994

Access Services are provided by means of wire, fiber optics, radio or  
any other suitable technology or a combination thereof.

(D)

[1] All subsequent tariff references will be referred to as U S WEST Communications.

(T)

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Issued: January 19, 1996

Effective: March 4, 1996

By: Director - Federal Regulatory Operations  
Room 4610  
1801 California Street  
Denver, Colorado 80202

8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES (Cont'd)

8.4.3 MEGA BIT SERVICE

(C)

A. MegaBit Subscriber Service

(N)

1. MegaBit Subscriber Service Charge,  
per termination

	USOC	NONRECURRING CHARGE	MONTHLY RATE
a. 256 kbps, bi-directional, dedicated connection			
• Monthly	HRLAM	\$69.00	\$29.95
• 12 Months	HRLA1	69.00	29.95
• 36 Months	HRLA3	69.00	29.95
• 60 Months	HRLA5	69.00	29.95
b. 512 kbps, bi-directional, dedicated connection			
• Monthly	HRLBM	69.00	65.00
• 12 Months	HRLB1	69.00	62.40
• 36 Months	HRLB3	69.00	59.80
• 60 Months	HRLB5	69.00	57.20
c. 768 kbps, bi-directional, dedicated connection			
• Monthly	HRLCM	69.00	80.00
• 12 Months	HRLC1	69.00	76.80
• 36 Months	HRLC3	69.00	73.60
• 60 Months	HRLC5	69.00	70.40

(N)

Certain material previously found on this page can now be found on page 8-116.

(Filed under Transmittal No. 985.)

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1801 California Street, Denver, Colorado 80202

8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES

8.4.3 MEGABIT SERVICE

A.1. (Cont'd)

(C)

	USOC	NONRECURRING CHARGE	MONTHLY RATE	(N)
d. 1 Mbps, bi-directional, dedicated connection				
• Monthly	HRLDM	\$69.00	\$125.00	
• 12 Months	HRLD1	69.00	120.00	
• 36 Months	HRLD3	69.00	115.00	
• 60 Months	HRLD5	69.00	110.00	
e. 4 Mbps receive, 1 Mbps send, dedicated connection				
• Monthly	HRLEM	69.00	500.00	
• 12 Months	HRLE1	69.00	480.00	
• 36 Months	HRLE3	69.00	460.00	
• 60 Months	HRLE5	69.00	440.00	
f. 7 Mbps receive, 1 Mbps send, dedicated connection				
• Monthly	HRLFM	69.00	875.00	
• 12 Months	HRLF1	69.00	840.00	
• 36 Months	HRLF3	69.00	805.00	
• 60 Months	HRLF5	69.00	770.00	(N)

Certain material previously found on this page can now be found on page 8-117.

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8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES

8.4.3 MEGABIT SERVICE

A. MegaBit Subscriber Services (Cont'd)

	USOC	NONRECURRING CHARGE	(C) (T) (N)
2. MegaBit Subscriber Change Charge, per order	REAKM	\$30.00	(N)

Certain material previously found on this page can now be found on page 8-118.

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8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES (Cont'd)

B. MegaCentral Access Link				(T)
	USOC	NONRECURRING CHARGE	MONTHLY RATE	(M)
• 1.544 Mbps[1]		[1]	[1]	
• 45 Mbps[2]		[2]	[2]	(M)
C. MegaCentral Port (BSE)				(T)
	USOC	NONRECURRING CHARGE	MONTHLY RATE	(M)
I. 1.5 Mbps, per Port				(M)
• Monthly	HPRGM	\$500.00	\$910.00	(T)
• 12 Months	HPRG1	500.00	455.00	(M)
• 36 Months	HPRG3	500.00	409.50	
• 60 Months	HPRG5	500.00	364.00	(M)

[1] See 7.5.9 for DS1 Service Channel Termination rates and charges.

[2] See 8.4.4 for ATM CRS Optical Access Link rates and charges or see 7.5.10 for DS3 Service Channel Termination rates and charges.

Certain material found on this page formerly appeared on Page 8-113.

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8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES (Cont'd)

C. MegaCentral Port (Cont'd) (T)

2. 45 Mbps, per Port[1] (M)

	USOC	NONRECURRING CHARGE	MONTHLY RATE	(M)
• Monthly	HPRKM	\$500.00	\$1,456.00	(T)
• 12 Months	HPRK1	500.00	728.00	(M)
• 36 Months	HPRK3	500.00	706.00	(M)
• 60 Months	HPRK5	500.00	692.00	(M)
	USOC		MONTHLY RATE	(M)
				(M)

D. Bandwidth[2] (T)

1. Each 3 Mbps Increment,  
up to 45 Mbps, per increment (M)

• Monthly	HB1HM	—	478.00	(T)
• 12 Months	HB1H1	—	239.00	(M)
• 36 Months	HB1H3	—	232.00	(M)
• 60 Months	HB1H5	—	227.00	(M)

[1] A minimum of one 3 Mbps Bandwidth increment applies for each 45 Mbps MegaCentral Port. The nonrecurring charge includes the installation of the Bandwidth increment(s) installed at the same time as the MegaCentral Port.

[2] Applicable only to the 45 Mbps MegaCentral Port. A minimum of one increment applies for each 45 Mbps MegaCentral Port.

Certain material found on this page formerly appeared on Page 8-114.

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8. ADVANCED COMMUNICATIONS NETWORKS

8.4 RATES AND CHARGES (Cont'd)

8.4.3 MEGABIT SERVICE

D. Bandwidth (Cont'd)

	USOC	NONRECURRING CHARGE	(M)	
2. MegaCentral Port Change Charge				
• 3 to 45 Mbps port speed bandwidth change, per speed change	REAKN	\$100.00		
	USOC	NONRECURRING CHARGE	MONTHLY RATE	(M)
E. Central Office Connecting Channel[1]				(T)
• Per connection		[1]	[1]	(M)

[1] See 7.5.9 or 7.5.10 for COCC rates and charges.

Certain material found on this page formerly appeared on Page 8-115.

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Issued: April 26, 1999

Effective: May 11, 1999

1801 California Street Denver Colorado 80202



Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
 Washington, D.C. 20554

**RECEIVED**  
 SEP 25 1998

FEDERAL COMMUNICATIONS COMMISSION  
 OFFICE OF THE SECRETARY

In the Matters of	)	
	)	
Deployment of Wireline Services Offering	)	CC Docket No. 98-147
Advanced Telecommunications Capability	)	
	)	
Petitions of Bell Atlantic Corporation	)	CC Dockets No. 98-11, 98-26
And U S West Communications Inc.	)	
For Relief from Barriers to Deployment of	)	
Advanced Telecommunications Services	)	
	)	
Petition of Ameritech Corporation to	)	CC Docket No. 98-32
Remove Barriers to Investment in	)	
Advanced Telecommunications Technology	)	
	)	
Petition of the Association for Local	)	CC Docket No. 98-78
Telecommunications Services (ALTS) for a	)	
Declaratory Ruling Establishing Conditions	)	
Necessary to Promote Deployment of	)	
Advanced Telecommunications Capability	)	
Under Section 706 of the Telecommunications	)	
Act of 1996	)	
	)	
Southwestern Bell Telephone Company,	)	CC Docket No. 98-91
Pacific Bell, and Nevada Bell Petition for	)	
Relief from Regulation Pursuant to Section	)	
706 of the Telecommunications Act of 1996	)	
and 47 U.S.C. § 160 for ADSL Infrastructure	)	
and Service	)	

**COMMENTS OF NORTHPOINT COMMUNICATIONS INC.**

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**A. Incumbent LECs Providing Advanced Services on an Integrated Basis Should Impute the Costs of the Monopoly Inputs Necessary to Provide Such Service**

Imputation is the most pressing issue currently facing the Commission. Unless ILECs that refuse to adopt a separate subsidiary arrangement are required to reflect the true costs of providing their ADSL service in their rates for that service, they will – and in fact already do – exert a price squeeze that makes entry by other carriers economically infeasible.

A price squeeze exists whenever a competitor that is equally efficient at providing the competitive portions of a service cannot, without losing money, meet the incumbent's retail price given the price(s) that it must pay to the incumbent for any bottleneck input(s) available only from the incumbent. A price squeeze can be the result of the markup over direct economic cost that the incumbent imposes for bottleneck inputs that both it and the competitor use or the incumbent's imposition of costs on the competitor that the incumbent does not bear at all. To avoid a price squeeze, the incumbent's retail price must equal or exceed the sum of the price that it charges to competitors for the bottleneck input(s) plus the total service long-run incremental cost of the competitively provided portions of the service.

Today, the ILECs proposed ADSL tariffs – which are being investigated by this Commission -- would exert just such a price squeeze. GTE, for instance, provides its ADSL service for as little as \$29 per month. By contrast, in California, CLECs must pay GTE almost \$19 for an unbundled digital loop necessary to compete, as well as an average of almost \$50,000 for collocation in each central office. Similarly, BellSouth is providing

J

FCC 96-325

**Before the  
Federal Communications Commission  
Washington, DC 20554**

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions in the Telecommunications Act	)	
of 1996	)	
	)	
Interconnection between Local Exchange	)	CC Docket No. 95-185
Carriers and Commercial Mobile Radio	)	
Service Providers	)	
	)	

**FIRST REPORT AND ORDER**

Adopted: August 1, 1996

Released: August 8, 1996

By the Commission: Chairman Hundt and Commissioners Quello, Ness, and Chong issuing separate statements.

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operator services for resale.<sup>2086</sup>

## 2. Discussion

871. Section 251(c)(4)(A) imposes on all incumbent LECs the duty to offer for resale "any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."<sup>2087</sup> We conclude that an incumbent LEC must establish a wholesale rate for each retail service that: (1) meets the statutory definition of a "telecommunications service;" and (2) is provided at retail to subscribers who are not "telecommunications carriers."<sup>2088</sup> We thus find no statutory basis for limiting the resale duty to basic telephone services, as some suggest.

872. We need not prescribe a minimum list of services that are subject to the resale requirement. State commissions, incumbent LECs, and resellers can determine the services that an incumbent LEC must provide at wholesale rates by examining that LEC's retail tariffs. The 1996 Act does not require an incumbent LEC to make a wholesale offering of any service that the incumbent LEC does not offer to retail customers. State commissions, however, may have the power to require incumbent LECs to offer specific intrastate services.<sup>2089</sup>

873. Exchange access services are not subject to the resale requirements of section 251(c)(4). The vast majority of purchasers of interstate access services are telecommunications carriers, not end users. It is true that incumbent LEC interstate access tariffs do not contain any limitation that prevents end users from buying these services, and that end users do occasionally purchase some access services, including special access,<sup>2090</sup> Feature Group A,<sup>2091</sup> and certain

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<sup>2086</sup> Bell Atlantic reply at 25.

<sup>2087</sup> 47 U.S.C. § 251(c)(4)(A).

<sup>2088</sup> "Telecommunications service" is defined in section 3(46) to mean "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." 47 U.S.C. § 153(46). "Telecommunications" is, in turn, defined in section 3(43) as "the transmission, between or among points specified by the user, of information of the user's choosing without change in the form or content of the information as sent and received." 47 U.S.C. § 153(43). "Telecommunications carrier" is defined in section 3(44) to mean "any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in section 226)." 47 U.S.C. § 153(44).

<sup>2089</sup> See, e.g., Illinois Public Utilities Act, Section 13-505.5.

<sup>2090</sup> End users may purchase special access from incumbent LECs in order to use high volume services offered by IXC's, such as AT&T's Megacom service.

Feature Group D elements for large private networks.<sup>2092</sup> Despite this fact, we conclude that the language and intent of section 251 clearly demonstrates that exchange access services should not be considered services an incumbent LEC "provides at retail to subscribers who are not telecommunications carriers" under section 251(c)(4). We note that virtually all commenters in this proceeding agree, or assume without stating, that exchange access services are not subject to the resale requirements of section 251(c)(4).<sup>2093</sup>

874. We find several compelling reasons to conclude that exchange access services should not be subject to resale requirements. First, these services are predominantly offered to, and taken by, IXC's, not end users. Part 69 of our rules defines these charges as "carrier's carrier charges,"<sup>2094</sup> and the specific part 69 rules that describe each interstate switched access element refer to charges assessed on "interexchange carriers" rather than end users.<sup>2095</sup> The mere fact that fundamentally non-retail services are offered pursuant to tariffs that do not restrict their availability, and that a small number of end users do purchase some of these services, does not alter the essential nature of the services. Moreover, because access services are designed for, and sold to, IXC's as an input component to the IXC's own retail services, LEC's would not avoid any "retail" costs when offering these services at "wholesale" to those same IXC's. Congress clearly intended section 251(c)(4) to apply to services targeted to end user subscribers, because only those services would involve an appreciable level of avoided costs that could be used to generate a wholesale rate. Furthermore, as explained in the following paragraph, section 251(c)(4) does not entitle subscribers to obtain services at wholesale rates for their own use. Permitting IXC's to purchase access services at wholesale rates for their own use would be inconsistent with this requirement.

875. We conclude that section 251(c)(4) does not require incumbent LEC's to make

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<sup>2091</sup> Feature Group A is similar to a local exchange service, but is used for interstate access. In such circumstances, the end user dials a seven-digit number to reach the LEC's "dial tone office" serving an IXC, where the LEC switches the call to the IXC's POP via a dedicated line-side connection. Feature Group A represents approximately one percent of incumbent LEC transport revenues.

<sup>2092</sup> Feature Group D is the set of elements through which IXC's today almost universally purchase switched access services from incumbent LEC's.

<sup>2093</sup> See, e.g., Cincinnati Bell comments at 34; Citizens Utilities comments at 25; NYNEX comments at 35 n.70; Rural Tel. Coalition comments at 20; J. Staurulakis comments at 6; SBC reply at 13; USTA reply at 31; Wisconsin Commission comments at Attachment, pp. 7-8.

<sup>2094</sup> 47 U.S.C. § 69.5(b).

<sup>2095</sup> The one exception, as discussed below, is the SLC, which is assessed on end users regardless of who purchases the access services from the incumbent LEC.